

If the retailer separately states the mandatory gratuity charge, and if the gratuity is distributed to the servers or other employees who participated directly in serving, preparing, hosting, or cleaning up the food or beverage function with respect to which the mandatory gratuity is charged, the gratuity is not subject to Retailers' Occupation Tax. See 35 ILCS 120/2-5(15). (This is a GIL.)

February 2, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated January 6, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We seek an opinion from your office concerning whether certain automatic charges imposed by a private club on all food and beverage transactions are gratuities or service charges.

Our client is a private club which serves food and beverages to Club members and their guests on its premises. Its annual revenues exceed one million dollars.

The Club imposes an automatic charge, variously described on some Club forms either as a 'service charge' or a 'gratuity', on all food and beverage transactions. The amount of the charge is 15% for a la carte service or 20% for banquet service.

The amount of the charge is set by the Club in advance of the service being rendered and without regard to the quality of the service. In other words, the member must pay the automatic 15% or 20% whether or not he or she feels the service merits such an amount.

The amount of these automatic charges is non-negotiable. The server is not authorized to modify or delete the charge. The member is normally presented with, and signs, a check or 'chit' when he or she is first seated and before the service is rendered. The chits come in various forms, some of which refer to 'service charge' being added, while others use the word 'gratuity'. We have attached copies of these forms.

If a member is dissatisfied with any aspect of his experience at the Club, the Club may, in its discretion, write off all or any portion of

the member's bill for a particular function. Such write offs could include the automatic charge.

The automatic charges appear on the member's monthly statement as 'service charges', in contrast to 'additional gratuities', which is how the statements describe tips left by members for particular servers. A copy of a typical monthly statement is also enclosed.

Normally, the automatic charge is not calculated until the checks or chits reach the accounting department, which does the calculation for each food, beverage or banquet transaction. On rare occasions, if a member asks to see his bill at the time the service is rendered, the server or a manager will manually calculate the automatic charge and add it to the bill so that the member can see his entire bill.

There are no cash transactions at the Club other than cash tips occasionally left by members for particular servers. All charges are signed for by the members and appear on the statement sent to the members by the Club each month.

The automatic charges variously described as service charges or gratuities are billed and collected by the Club under a separate accounting code. The Club reports the charges as 'service charges' to state revenue authorities and pays sales taxes on the amounts so reported.

At one time the Club distributed a portion of these automatic charges to its servers. In May of 1993 the servers voted approval of a change in their own method of compensation so that instead of a low base rate and a share of the automatic charge, they received a higher flat rate several dollars in excess of the state and federal minimum wage, but no portion of the automatic charge.

Our questions are as follows:

1. Do the amounts collected as automatic charges belong to the Club or to the servers?
2. Would your opinion change if the members who pay the automatic charges believe that such charges are distributed to the servers?

Thank you very much for your time and thoughtful opinion. If at all possible, we request that you provide your opinion at your earliest convenience within the next ninety days. If you have any questions regarding the above facts, please call me at ####, and I will follow up with a clarifying letter.

The proceeds of mandatory service charges separately stated on customers' bills for the purchase and consumption of food and beverages purchased at retail from a retailer are exempt from tax to the extent that the proceeds of the service charge are in fact turned over as tips or as a substitute for tips to the employees who participate directly in preparing, serving, hosting or cleaning up the food or beverage function with respect to which the service charge is

imposed. This procedure is required by the enclosed copy of 35 ILCS 120/2-5(15) (1996 State Bar Edition).

Therefore if the employer separately states the mandatory gratuity charge, and if the entire gratuity is distributed to the servers or other employees who participated directly in serving, preparing, hosting, or cleaning up the food or beverage function with respect to which the mandatory gratuity is charged, the gratuity is not subject to Retailers' Occupation Tax.

However, if the employer retains and uses the entire mandatory service charge for any other use, including to pay employee wages, the mandatory gratuity/service charge is subject to tax.

I hope this information is helpful. The Department of Revenue maintains a Web site which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.